



CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

AGENDA DATE: April 8, 2008

TO: Mayor and Councilmembers

FROM: Human Resources, Administrative Services Department

SUBJECT: Amendment To The City's Deferred Compensation Plan Authorizing Plan Loans

RECOMMENDATION:

That Council authorize the Finance Director to execute documents to amend the City's Section 457 Deferred Compensation Plan Documents to authorize participant loans.

BACKGROUND:

The City offers its employees an optional supplemental retirement savings plan. Known as a "457 Plan" after the section of the Internal Revenue Code (IRC) that authorizes the plan, the 457 plan is the public sector equivalent to the private sector's 401(k) plan. City employees may defer, pre-tax, up to \$15,500 of their income annually. There are higher annual contribution limits for employees over age 50. The City makes no contributions.

The City offers employees a choice of two deferred compensation providers, Great-West Retirement Services and the ICMA Retirement Corporation. Both of the providers offer participating employees an extensive range of investment alternatives including a diversified selection of mutual funds, bond and money market funds. Participating employees choose from among the investment alternatives offered by the providers. While participating employees are responsible for their own investment choices, both providers offer investment guidance and one-on-one support in quarterly onsite meetings.

As of December 31, 2007 there were a total of 959 employee accounts (active employees and retirees) with total assets of \$53.4 million. This equates to an average account balance of approximately \$55,700.

Under IRC Section 457 regulations, employees may not withdraw funds from their account until they separate from City service. The only exceptions to this rule are several narrowly defined cases of "unforeseen financial hardship."

REVIEWED BY: _____ Finance _____ Attorney _____ Name of Additional Department(s) That Need to Review CAR

Agenda Item No. _____

DISCUSSION:

In 2001, the Internal Revenue Service amended the Section 457 regulations to allow participants to borrow against their account balances. Under the IRS regulations, plan participants may borrow up to 50% of their account balance or \$50,000, whichever is less. Participants may borrow against their account balances for any reason. The borrowed amount is withdrawn from the employee's account and disbursed to the employee. The employee then repays himself/herself with interest. The following are the essential loan program terms:

Loan amount	50% of account balance or \$50,000, whichever is less. Minimum loan amount is \$1,000.
Loan term	Up to 15 years for loans taken to fund the purchase of a principal residence. Up to 5 years for all other loans.
Interest Rate	Fixed at Prime Rate + 1%.
Number of loans Permitted	No more than one loan outstanding at any one time. However, if an employee has an account with each provider, then the employee may have one loan from each account. In no case may the total of the loans exceed 50% of the combined value of the accounts or \$50,000, whichever is less.
Repayment	Repayment will be either through biweekly payroll deduction or monthly direct debit to the participant's bank account.
Prepayment	Loans may be prepaid at any time without penalty.

If the participant defaults on his/her loan payment, the unpaid balance of the loan is considered a "deemed distribution" and is reported to the Internal Revenue Service and California Franchise Tax Board as taxable income in the year of the default. Participants are given ample opportunity to cure a loan default prior this occurring. Of course, this is not an issue if the employee is using payroll deduction to make the payments.

While the general loan terms cited above are established by IRS regulations, there is one notable administrative difference between the City's two providers. Great-West Retirement Services requires that loan payments be made through payroll deduction. Therefore, loans from Great-West accounts become due and payable in full when an employee separates from City service. Of course, once an employee separates from City service, they have legal access to their entire account balance regardless of age and without penalty. On the other hand, the ICMA Retirement Corporation allows loan repayments through direct

(ACH) debit to a participant's bank account. This allows participants with loans from an ICMA Retirement Corporation account to continue making payments on their loan after separation from City service.

While the 457 Plan is intended as a retirement savings account, there are situations where borrowing against the plan will make financial sense for a participating employee. One of the prime examples would be for the purchase of a home. Other examples may be to help pay for a child's college education or home improvements. Staff believes that it is appropriate to make this financial option available to employees. It is also possible that doing so may encourage more employees to participate in the deferred compensation program because they will know that if a need arises, they will be able to access a portion of their savings without having to separate from City service.

SUBMITTED BY: Robert D. Peirson, Finance Director

APPROVED BY: City Administrator's Office